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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

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| Market Dominant Product Prices<br>Standard Mail<br>Discover Financial Services | Docket No. MC2015-3 |
| Market Dominant Product Prices<br>Discover Financial Services (MC2015-3)<br>Negotiated Service Agreement | Docket No. R2015-2 |

PUBLIC REPRESENTATIVE COMMENTS

(November 17, 2014)

## 1. Introduction

The Postal Service signed an agreement with Discover Financial Services (DFS) that offers a rebate of up to 2.5 percent for all postage, provided DFS mails over $313 million in First Class and Standard Mail.[1] The Postal Service has offered no actionable evidence that this agreement will meet statutory and regulatory requirements for market dominant NSAs. In this proceeding, the Postal Service has provided an incomplete record that offers insufficient information about this agreement and the likely consequences of its implementation. As detailed in these comments, the Postal Service has not proffered a methodology that can be used to determine that the NSA meets the regulatory and statutory requirements. The incompleteness of the record in this proceeding impedes the ability of commenters and the Commission to assess whether the agreement complies with statutory and regulatory requirements. The Public Representative suggests that the Commission should hold the proceeding in abeyance until a meaningful understanding of the impact of the agreement is developed.

## 2. Procedural History and Record Evidence

[1] Notice of the United States Postal Service of Filing Request to Add Discover Financial Services Negotiated Service Agreement to the Market-Dominant Product List, October 27, 2014 (Postal Service Notice). The Rebate Threshold increases to $316 million in year 2 and $319 million in year 3 of the three year contract.

On October 3, 2014, the Postal Service signed a negotiated service agreement (NSA) with DFS.[2] The Board of Governors approved the prices outlined in the agreement on October 17, 2014.[3] On October 27, 2014, the Postal Service provided the Commission notice that the Board of Governors had authorized the agreement and requested that the Commission add the DFS NSA to the market-dominant product list.[4] The Postal Service requests that this approval occur before December 1, 2014, the implementation date envisioned in the agreement.[5]

On October 28, 2014, the Commission issued Order No. 2231 which invited "comments on whether the Postal Service's filing in the captioned dockets are consistent with the policies of 39 U.S.C. 3622 and 3642, as well as 39 CFR parts 3010 and 3020" by November 17, 2014.[6]

### a. Explanation of Agreement

The DFS NSA has a straightforward concept. DFS and the Postal Service have agreed to rebate thresholds. If DFS exceeds the rebate threshold, it will receive 2.25 or 2.5 percent of total revenue paid (depending on the rebate tier), in the form of a rebate. If DFS does not meet the revenue threshold, it is required to pay a penalty. The revenue threshold encompasses DFS revenue on both First Class and Standard Mail.

There are two rebate tiers. Tier 1 provides a rebate of 2.25 percent on revenue, and Tier 2 provides a rebate of 2.5 percent. While the contract contains a calculation of these values using a formula, the values of the tier thresholds for the contract have already been set. The following table details the rebate structure for the three year contract. Appendix B contains a discussion of how the rebate tier structure will operate.

**Table 1: DFS NSA Rebate Tier Thresholds**

[2] Postal Service Notice, Attachment B, at 10.
[3] Postal Service Notice, Attachment A, at 1.
[4] Postal Service Notice.
[5] Postal Service Notice at 1.
[6] Commission Order No. 2231 at 4.

| | Contract Year 1 | Contract Year 2 | Contract Year 3 | | Rebate |
|---|---|---|---|---|---|
| Tier 1 | $ 313,174,665 | $ 316,215,196 | $ 319,255,726 | | 2.25% |
| Tier 2 | $ 316,215,196 | $ 319,255,726 | $ 322,296,257 | | 2.50% |

### b. Record Evidence of Net Financial Impact to the Postal Service

#### i. Commission Method

Pursuant to the Commission's rules and in response to CHIR No. 1, question 3, the Postal Service attempted to provide an analysis of the DFS NSA using the Commission's approved methodology. The Postal Service's spreadsheet contained numerous errors and was formatted in a way that made the data particularly challenging to work with.[7] The Public Representative has corrected the errors in the Postal Service's analysis, including accounting for the value added by the potential contribution from the penalty clause.[8] The following table details a potential range of outcomes from the DFS NSA.

**Table 2: Potential Net Profit of DFS NSA - Commission Methodology**

| | Forecast -10% Volume | Postal Service Forecast | Forecast +10% Volume |
|---|---|---|---|
| | | | |
| Year 1 | $ 2,101,676 | $ (6,181,368.42) | $ (6,799,505.27) |
| | | | |
| Year 2 | $ 2,888,317 | $ (6,168,739.41) | $ (6,785,613.35) |
| | | | |
| Year 3 | $ 2,635,597 | $ (6,306,561.14) | $ (6,937,217.26) |
| | | | |
| **Total** | **$ 7,625,590** | **$ (18,656,669)** | **$ (20,522,336)** |

[7] The excel document that the Postal Service provided in response to CHIR No. 1, question 3, entitled "CHIR No.1_QU3b.xls," was hardcoded and used several formatting techniques that made the data particularly difficult to work with. In particular, all of the numbers provided were transformed into characters and contained spaces. As an example, the Year one First Class revenue in the spreadsheet was "______0.397" instead of "0.397." The entry of "____0.397" made it impossible for excel to read the cell's content as a number, and thus made it impossible to manipulate or make calculations with any part of the spreadsheet. The Public Representative requests that the Commission enforce its regulations regarding non-hardcoded spreadsheets without specialized formatting in the future.

[8] The Public Representative corrected several errors. For example, as shown below, the Postal Service calculates that a 10 percent change in volume does not impact the rebate amount in contract year 2.

| | |
|---|---|
| **$ 7,981,445** | **$ 7,981,445** |
| $ 2,270,068 | $ 2,270,068 |
| $ 5,711,378 | $ 5,711,378 |

The starting point for the analysis is the Postal Service's forecast of DFS volume and revenue for each contract year. For example, the Postal Service projects that DFS will mail 232 million First Class letters and 1.023 billion Standard Mail letters in contract year one, with a total revenue of $324 million before any discounts ($316 million after discounts). From there, a 10 percent sensitivity analysis was performed. For the contract year one "Forecast – 10%," the hypothetical volume is 209 million First Class and 921 million Standard Mail letters with revenue of $292 million.

In the "Forecast – 10 percent" scenario, DFS is projected to fall short of the rebate threshold, and thus pay a penalty. Since the penalty would not have been paid without the contract, the penalty revenue increases the net contribution to the Postal Service.

If DFS reaches the rebate threshold and triggers the rebate, the DFS NSA is projected to lose upwards of $18 million in contribution over the life of the agreement, using the Commission's methodology. This result, in a sense, is predetermined by the nature of the agreement and the methodology. The Commission methodology for assessing the financial impact of an NSA incorporates the contract rebated volume, the marginal rebate of the final piece, and the Standard Regular and First Class workshared subclass own-price elasticities. This methodology is intended to assess the marginal response to price incentives.

The contract provides rebates across all volume, not just to encourage the contract partner to maximize volume by extending the demand curve. DFS is projected to mail over 1 billion pieces. If the rebate threshold is reached, the first piece will receive the same marginal discount as the 1 billionth piece. The marginal discount for Standard Mail is projected to be 0.57 cents per piece (2.5 percent of the average revenue of 22.7 cents). With a total volume of 1.023 billion pieces, an elasticity of -0.457[9], and a marginal rebate of 2.5 percent, the additional volume generated is estimated to be 11.7 million pieces. The rebate is estimated to be given to 1.012 billion pieces before the contract partner is incentivized by the discount to add volume.

[9] This represents the Standard Mail regular workshared letters subclass elasticity.

### c. Postal Service Statement of Net Financial Benefit

The Postal Service provides a statement regarding the potential value of the agreement. In its Notice, the Postal Service states:

> Without an NSA, the total volume for First Class Mail and Standard Mail is projected to be approximately 1,030 million pieces, and total revenue is projected to be approximately $268 million in Year 1. With an NSA, the Postal Service believes that DFS would be incented to increase its aggregate mail volume to reach the volume and revenue thresholds to qualify for rebates. After deducting rebate payments, revenue in Year 1 of the agreement term is projected to be approximately $317 million, about $49 million higher than the projected revenue without incentives in Year 1.[10]

The Postal Service further states:

> Based on DFS's volume and revenue trends, and the Postal Service's mail volume in Postal Fiscal Year 2014, the Postal Service estimates that the total volume of DFS's Eligible Mail will decrease by approximately 873 million pieces (23%) over the next three years in the absence of this NSA. In order to qualify for a rebate under the NSA, DFS will have to increase the aggregate DFS Eligible Mail volume at a rate greater than these projections.[11]

The Postal Service states that "the NSA should result in an estimated aggregate contribution after rebate of $91.4 million and approximately $969.4 million in total revenue."[12] The Postal Service concludes "that this NSA will improve the net financial position of the Postal Service and that it is appropriate to add it to the market-dominant products list. The Commission should therefore approve this request as set forth in its rules."[13] The following table summarizes the Postal Service's statement of the net value of the DFS NSA.

**Table 3: Potential Net Profit of DFS NSA – Postal Service Statement**

| | Contract Year 1 | Contract Year 2 | Contract Year 3 |
|---|---|---|---|
| **Before-Rates Volume** | | | |
| First-Class Mail | 201,009,500 | 193,974,168 | 187,185,072 |
| Standard Mail | 828,784,277 | 780,714,789 | 735,433,331 |
| **Incremental Volume** | | | |
| First-Class Mail | 31,621,918 | 41,579,390 | 48,368,487 |
| Standard Mail | 194,796,365 | 255,723,302 | 301,004,761 |
| | | | |
| **Total Rebates** | $ 8,116,309 | $ 7,981,445 | $ 8,136,104 |
| **Postal Service Net Financial Value** | $ 23,536,897 | $ 30,488,934 | $ 37,415,849 |

[10] Notice at 13.
[11] Notice at 14.
[12] Notice at 15.
[13] Notice at 15.

The Postal Service states the net financial benefit of the NSA will increase from $23.5 million in contract year 1 to $37.4 million in contract year 3, for a total value of$94 million.

#### d. Summary of the Net Financial Benefit Analyses

Using the Commission's methodology, the agreement is estimated to have an impact of negative $18 million. The Postal Service states that the agreement will have in impact of positive $94 million. The gap in valuation is $112 million. Under both methods, DFS is projected to receive $24 million in rebates.

### 3. The Postal Service fails to demonstrate the NSA improves its net financial position as required by 39 U.S.C. 3622 (c)(10)(A)(i).

In Docket No. R2011-3, the Commission evaluated the first domestic market dominant NSA under PAEA. In Order No. 694, the Commission summarized the statutory and regulatory provisions relevant to market dominant NSAs:

> The appropriate statutory and regulatory provisions require the Commission to make a finding under 39 CFR 3010.40(a) that the proposed market dominant negotiated service agreement must either "(i) improve the net financial position of the Postal Service" (39 U.S.C. 3622(c)(10)(A)(i)); or "(ii) enhance the performance of various operational functions" (39 U.S.C. 3622(c)(10)(A)(ii)). Additionally, the negotiated service agreement may not "cause unreasonable harm to the marketplace" (39 U.S.C. 3622(c)(10)(B)) and "must be available on public and reasonable terms to similarly situated mailers." 39 CFR 3010.40(b), (c). Order No. 694 at 11-12.

As required by statute and the Commission's implementing regulations, a market dominant NSA must either improve the net financial position of the Postal Service or enhance the performance of various operations functions.[14] In response to CHIR No. 1, question 4, the Postal Service states that the proposed NSA will not "further performance enhancements." Thus, in order to approve the DFS NSA, the Commission must find that the NSA improves the net financial position of the Postal Service as required by the PAEA. Despite this requirement, the Postal Service has failed to meet its burden and demonstrate that the proposed NSA will improve its net financial position.

#### a. The Postal Service is aware of the Commission methodology

[14] Additionally, these NSAs are intended to be available with similar terms for similar mailers. As the Postal Service has done in the past, this possibility is mentioned in passing.

The new DFS NSA is the third domestic market dominant NSA that the Postal Service has entered into with DFS. In both of the previous DFS NSAs, a common theme has been a disagreement between the Postal Service and the Commission concerning the methodology that should be used to calculate the net financial benefit to the Postal Service from the agreement.

The first DFS NSA, evaluated in Docket No. MC2004-4, was filed over 10 years ago under the Postal Reorganization Act. In Docket No. MC2004-4, the Commission determined that the volume discounts aspect of the agreement was likely to lose money for the Postal Service, but the impact of the operational improvement aspect of the agreement was likely result in larger savings. The Commission approved that agreement because it determined that the agreement was likely to improve the net financial position of the Postal Service.[15] The key to that NSA was the savings from ACS savings. The Postal Service made significant operational improvements in address corrections during the agreement, and much of the operational savings specific to the agreement evaporated. The Commission estimated that the Postal Service lost money on the discounts provided during the agreement, but the operational savings were enough for the Postal Service to realize a net benefit of $1.427 million from the 3 year agreement.

In Docket No. R2011-3, the Commission determined that the agreement was "unlikely to increase the net contribution to the Postal Service."[16] Specifically, the Commission noted that it had "reservations about the methods used by the Postal Service to estimate what DFS's volumes would be in the absence of the agreement."[17] The Commission used its accepted methodology to analyze the financial impact of the agreement. Recognizing "the absence of a quantitative proposal for measuring the effect of the agreement on the Postal Service's finances," the Commission analyzed the agreement using its previously accepted methodology for determining the effect of

[15] See Docket No. MC 2004-4 Opinion and Recommended Decision Approving Negotiated Service Agreement at 3. http://www.prc.gov/Docs/41/41896/Opinion.pdf
[16] Order No. 694 at 14.
[17] Order No. 694 at 13.

negotiated agreements on mail volume."[18] However, the Commission evaluated the market context for the agreement and determined that the Postal Service would "enhance its knowledge of potential tools to slow the overall declining trend for First Class Mail volume."[19] The Commission approved implementation of the NSA, stating that "[g]iven the totality of the circumstances presented, the Commission finds that the agreement may proceed pursuant to section 3622(c)(10)."[20]

### i. The DFS NSA is similar to the prior DFS NSA – Rebates for all volume

The proposed DFS NSA provides DFS with rebates for all volume mailed, provided that a revenue threshold is reached. This is the same rebate structure of NSA as the previous DFS NSA. In the new DFS NSA, the amount of revenue required to activate the rebates and the percentage amount of the rebates is predetermined, a departure from the previous NSA. The overall structure remains the same.

As in Docket No. R2011-3, the Postal Service, for its own evaluation of the benefit of the agreement, has stated DFS volume absent the agreement. As in Docket No. 2011-3, the Postal Service has not provided the Commission with a quantitative methodology it used for estimating the impact of the agreement.

### ii. The Postal Service has failed to demonstrate that the previous DFS NSA provided a net financial benefit.

As the first domestic market dominant NSA that offered rebates across all volume for the purpose of incentivizing volume, the previous NSA had a novel structure. The Postal Service has failed to provide the Commission with an analytical approach that would show a net financial benefit from offering volume incentive rebates to all volume. The Commission evaluated the previous DFS NSA using its accepted methodology in Order No. 694. The Commission has also used the accepted methodology in its review of the first two contract years of the agreement in the FY 2012 and FY 2013 Annual Compliance Determinations. The Commission determined that

[18] Order No. 694 at 14.
[19] Order No. 694 at 16.
[20] Order No. 694 at 16.

the NSA had a financial impact to the Postal Service of negative $11.2 million dollars in the first two years of the agreement. In the FY 2013 ACD, the Commission noted that the previous agreement was "designed to pay rebates for all of DFS's qualifying volume, and in contract year 2 the rebate was greater than the contribution incentivized by the agreement. As implemented by the Postal Service, the NSA is inconsistent with section 3622(c)(10)."[21]

**b. The Postal Service has designed a NSA that fails to meet statutory and regulatory requirements.**

The DFS NSA proposed in this docket does not meet requirements of 39 U.S.C. 3622 (c)(10)(A)(i) when the Commission's accepted methodology is applied, as required by 39 C.F.R. 3010.42(f). The Commission has determined that the previous DFS NSA did not satisfy the statutory requirements for NSAs. The proposed NSA, while different in rebate thresholds and rebate amounts, functions in largely the same manner. In the workpapers filed with its Notice, the Postal Service provided an analysis of the first year of the contract using the Commission's methodology. The Postal Service detailed that the agreement is projected to decrease overall contribution by $6 million in the first year. In response to CHIR No. 1, the Postal Service estimated that the agreement would reduce contribution by over $18 million across the 3 years of the agreement.

The negative impact of this NSA projected using the Commission's methodology is no surprise. It is the same methodology used to analyze both of the previous DFS NSAs. The Public Representative is concerned that the Postal Service now advocates for approval of an agreement that does not meet the statutory requirement that it provides a net financial benefit for the Postal Service.[22]

[21] FY 2013 Annual Compliance Determination at 68.

[22] It should be noted that if DFS fails to reach the rebate threshold, the penalty would improve the net financial position of the Postal Service. As the Postal Service projects that DFS will reach the rebate threshold, this aspect of the agreement should not be relied upon to claim that the agreement is likely to increase contribution. Simply, it seems unlikely that DFS signed an agreement with the intent of paying a penalty. It is also reasonable to assume that if DFS is unlikely to reach the rebate threshold, it will cancel the agreement.

Under Commission regulations, the Postal Service can provide an alternative methodology to the Commission's accepted methodology, but must explain why Commission's methodology is "not the most accurate and reliable methodology available." 39 CFR 3010.42(f)(5). The Postal Service not provided the Commission with an alternative methodology that can be used to evaluate the financial impact of this NSA. The Postal Service has not filed a petition for a rulemaking to alter the methodology.

**4. The Postal Service has not met its burden of proof.**

The Postal Service has requested that the Commission approve implementation of the proposed agreement. The Postal Service has the responsibility of providing the Commission and stakeholders with the information needed to ensure transparency and accountability and that the agreement conforms to the requirements of the law. The Postal Service has made little, if any attempt to meet this burden. Instead, the Postal Service has provided an alternative "black box" statement of the value of the agreement.

To be clear, the statements the Postal Service have provided regarding its valuation of the agreement do not amount to a methodology. A methodology is "a set or system of methods, principles, and rules for regulating a given discipline."[23] In this instance, the given discipline is: the analysis of mailer response to price changes. The Postal Service has not provided an alternative methodology because it has offered no set, or system, or methods, or principle, or rules concerning how mailer response should be measured. The unsupported statement that without the agreement, DFS will mail 201,009,000 pieces of First-Class Mail without the agreement and 232,631,418 with the agreement is not a methodological analysis; it is a guess. A methodology creates transparency, allows for discussion, and creates a basis from which to make adjustments. A methodology allows for accountability.

Because the Postal Service offers no methodology to support its assertions, these assertions cannot be evaluated or assessed. When the Postal Service's

[23] http://dictionary.reference.com/browse/methodology

estimates turn out to be incorrect, stakeholders cannot evaluate the underlying methodology and assess why the error occurred. Potentially more important, because the Postal Service does not have a methodology to understand how mailers respond to individualize price changes it cannot use its experience to improve its own understanding of such agreements.

The Postal Service asserts that the Commission should not apply its methodology to analyze the impact of this NSA. In response to CHIR No. 1, question 3, the Postal Service states:

> The Postal Service believes that the Commission's methodology for determining the Net Value of an NSA fails to take into account how a particular mailer will react to the marginal discount provided. The Class Elasticity employed in the Commission's methodology assumes that all mailers will react to changes in price the same way. We believe this assumption is incorrect as it does not reflect or take into account the actual behavior of the mailer. We believe that the mailing behavior of companies, including but not limited to Discover, is influenced by marginal discounts such as those contained in the present Discover NSA.

While the Postal Service has many "beliefs" about the Commission's methodology and the DFS NSA, the Postal Service fails to support those beliefs on the record with evidence or proof. Without evidence or proof, the beliefs of the Postal Service amount to argument. This argument does not meet the burden of proof required to change methodologies—that is, a showing that the Commission's methodology is not the most accurate and reliable methodology available.

Similarly, in response to CHIR No. 1, question 2, the Postal Service states:

> The Postal Service is cognizant of the Commission's analysis of the prior Discover NSA contained in the March 27, 2014 Annual Compliance Determination; however, we believe that the net value method employed in the current NSA is better suited to commercial corporate activities. Furthermore, we believe that our innovative quantitative analytical methodology which leverages both volume and revenue thresholds is more reflective of corporate business practices, including but not limited to, companies such as Discover.

The Postal Service believes in its statement of valuation and its "innovative quantitative analytical methodology."[24] However, it is unclear from the record what methodology this statement alludes to. The "quantitative analytical methodology" is not mentioned in the Postal Service's Notice. In fact, the only place the word "methodology"

[24] For its evaluation of previous NSAs, the Postal Service has applied a qualitative model to estimate before rates volumes. See Order No. 694 at 13.

appears in the Postal Service's Notice is in the Data Collection Plan, in reference to the Commission's methodology.

The record in this docket is clear. The Postal Service has not provided any evidence demonstrating a methodology. Without any demonstration of the superiority of the Postal Service's approach, the Commission is left with its accepted methodology—which shows the DFS NSA will result in significant financial detriment to the Postal Service.

**a. The Postal Service has a poor track record of predicting mailer volumes.**

In every domestic market dominant NSA, the Postal Service proffers a statement of what the contract partner will mail with and without implementation of the agreement. The Postal Service has provided 8 such statements in previous NSAs. Appendix A contains the details of the Postal Service's statement of contract partner volumes for each NSA, with and without the agreement, and the actual volume.[25] The verdict on the Postal Service's statements of mailer volumes is in: In the first year of a contract, the Postal Service misses the mark by 7.7 percent on average; in the second year of a contract, the Postal Service's stated prediction of mailer volume is off by 14.0 percent on average; in the third year of the contract the Postal Service's stated prediction of mailer volumes is off by 24.2 percent, on average.

The Postal Service states that the Commission's method doesn't capture reality, but fails to offer a reasonable and supported alternative. The Postal Service's track record of predicting mailers volumes shows that those predictions cannot be used to predict the effects of agreements. Further, they cannot be used to measure the impact of an agreement after the fact. Market conditions constantly shift, and even mailers struggle to predict what they will send in future years.[26]

**b. Postal Service projection of DFS volume fails in light of basic economic principles.**

[25] The previous DFS Docket No. R2011-3 NSA focused on revenue instead of volume, and thus revenue instead of volume is used.
[26] See GAO-13-578 at 24. http://www.gao.gov/assets/660/655387.pdf

The Postal Service does not have a stellar track record of using its “black box” to produce accurate volume forecasts. The statement of future DFS volumes that the black box has produced in this docket is especially difficult to understand. The following table details the Postal Service projection of DFS Year 1 and Year 2 volume without implementation of the NSA.

**Table 4: Postal Service Statement of Exigent Surcharge and Rebate Interaction**

| | Without Agreement Year 1 | Price Change - Exgient Surcharge Removal | Without Agreement Year 2 | Potential NSA Rebate | With Agreement Year 2 |
|---|---|---|---|---|---|
| **Postal Service Projection of DFS Volume** | 1,029,793,777 | -4.3% | 974,688,957 | 2.5% | 1,271,991,650 |
| **Volume Difference** | | | (55,104,820) | | 297,302,693 |
| **Percent Difference** | | | -5% | | 31% |

The Postal Service states that DFS will decrease its volume by 5 percent from year 1 to year 2 if the agreement is not implemented. While this is certainly a potential outcome, the Postal Service notes that the current exigent surcharge is likely to be removed at some point between the beginning of contract year 1 and the end of contract year 2. Although the Postal Service expects that DFS will experience a price decrease with the removal of the exigent surcharge, its black box states that volume will decline regardless.

The final two columns of this table shift to the Postal Service’s black box statement of DFS’ volume in contract year 2 if the agreement is implemented. The Postal Service states that DFS’ volume will increase by nearly 300 million with the agreement. The two estimates taken together defy both logic and basic principles of economics. No sound methodology would produce a 5 percent volume decrease with a 4.3 percent price decrease, but a 31 percent volume increase with a 2.5 percent price decrease.

### c. Postal Service is unwilling to provide evidence

The Commission’s stated reason for approving the previous DFS NSA was to allow the Postal Service to improve its understanding of how to stem volume losses from First-Class Mail. In response to CHIR No. 1, question 2, the Postal Service provided 2.5 pages of discussion of the lessons learned from the previous DFS NSA. The Postal Service has failed to detail lessons learned from the agreement.

The Postal Service learned that because the Postal Service expected DFS volume to decline, and it increased, the DFS NSA was a success.[27] The Postal Service stated "[b]ased on an analysis of industry performance, we projected that Discover would mail less without the prior NSA."[28] The Postal Service argues that it realized a financial benefit because DFS did not decrease its volume, which would have led to a decline in contribution. The Postal Service states that "[n]ot only did the NSA allow that $61M decline in contribution to be avoided, but, contribution over the 3-year NSA period actually increased by $10 million for a total benefit of almost $71m." The Postal Service did not provide any workpapers allowing parties and the Commission to evaluate its statement. The following table summarizes the Postal Service's statements regarding its interpretation of the value of the prior agreement to the Commission, as provided in data collection reports and ACD filings.

**Table 5: Postal Service Statement of Docket No. R2011-3 Value**

| | High Estimate | Low Estimate |
|---|---|---|
| **Contract Year 1** | $ 23,567,688 | $ 25,513,070 |
| **Contract Year 2** | $ 22,283,069 | $ 26,753,301 |
| **Contract Year 3** | $ 16,026,972 | $ 24,004,658 |
| | $ 61,877,729 | $ 76,271,028 |

In its Data Collection Reports, the Postal Service has stated that the agreement increased contribution between $61.9 and $76.3 million. In this proceeding, the Postal Service represents that the value was $71 million. Because the Postal Service has not furthered transparency and filed its workpapers, understanding the rationale for the new valuation is difficult. Further, the Postal Service states that much of the value of the DFS NSA was driven by the fact that DFS volume and contribution went up during the agreement, instead of declining with the rest of the industry.

[27] Even though the Postal Service's DFS revenue estimate was over 20 percent off from the actual mark, the Postal Service states that it learned that it had correctly predicted what its contract partner would have done without the agreement.

[28] Postal Service Response to CHIR No. 1, question 2 part 2.

In an attempt to understand the industry specific volume trends the Postal Service is referencing, the Public Representative researched industry specific mail volumes. The following table, taken from the DMA "2014 Statistical Fact Book," contains volume estimates by sectors.[29]

**Table 6: Direct Mail Volume by Sector, 2008-2013**

DIRECT MAIL VOLUME BY SECTORS, 2008 – 2013

| Estimated Mail Volume Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|
| Banking | 1,416,981,133 | 1,221,682,327 | 1,317,482,192 | 1,174,635,171 | 1,074,227,475 | 1,227,090,291 |
| Credit cards | 8,195,095,358 | 3,797,945,738 | 6,621,124,237 | 7,001,535,271 | 5,270,179,724 | 6,351,997,481 |
| Insurance | 8,211,073,014 | 8,390,523,324 | 9,381,448,576 | 6,882,636,991 | 6,943,287,353 | 6,965,072,390 |
| Investment | 485,747,412 | 348,869,384 | 316,266,093 | 337,569,856 | 386,387,791 | 371,234,692 |
| Mortgage & loans | 3,150,740,433 | 1,083,200,219 | 1,163,040,711 | 1,331,912,134 | 1,878,121,982 | 2,574,549,331 |
| Shipping | 410,479 | 21,145,033 | 97,241,999 | 39,324,249 | 52,785,566 | 114,340,301 |
| Technology | 239,387,935 | 184,338,538 | 101,010,518 | 74,689,717 | 56,893,471 | 97,100,150 |
| Telecoms | 3,951,710,832 | 4,387,090,641 | 4,247,851,773 | 3,331,477,637 | 3,592,519,721 | 3,811,985,494 |
| Travel/Leisure | 458,369,409 | 481,936,118 | 474,759,023 | 427,786,188 | 494,219,675 | 529,827,310 |

Source: Mintel, 2013.

As detailed in this table, the direct mail entered by the Credit Card sector was stable from 2011 to 2013 as compared with 2008 to 2010. The Postal Service has a significant informational advantage over outside stakeholders. It is possible that the Postal Service's statements in its filings regarding the state of DFS' industry are accurate, but the Postal Service has provided no information on the record to support them. Further, the accuracy of these statements is called into question by publicly available data, such as the DMA Fact Book.[30]

The Postal Service further states that it "learned that the methods employed to staunch declining FCM volume may vary for each mailer."[31] The Postal Service presumably learned this because the previous DFS NSA was unable to prevent a drop in DFS First-Class volume. However, it is unclear what the Postal Service means when it states that methods to staunch the decline vary by mailer, as the only mailer with an

[29] This table is publically available at http://main.vma.bz/guest-blogging/direct-mail-its-back

[30] Additional publicly available data regarding credit card solicitation volume does not support the Postal Service's assertions regarding the performance of the credit card industry from 2010 to 2012. See http://www.hispanicmpr.com/2012/06/13/direct-mail-credit-card-offers-drop-33-percent/, which shows that credit card offers increased by 43 percent from CY 2010 to CY 2011, even with a precipitous drop at the end of 2011.

[31] Postal Service Response to CHIR No. 1, question 2 part 3.

NSA that covered First-Class volume thus far in the PAEA era was DFS - and its First-Class volume was not stabilized by the NSA.

### d. How this NSA and the exigent surcharge use price elasticities differently

In Docket No. R2013-11, the Postal Service requested an exigent price increase above the CPI cap. An important aspect of the Postal Service's argument for the exigent price increase was that mailers are generally price inelastic. The Postal Service argued that mailers have low price sensitivity, and thus the Postal Service is able to gain additional profit by increasing prices. Mailers argued that the Postal Service mis-estimated elasticities, and thus price increases would be counterproductive. The Commission agreed with the Postal Service's analysis that mailers are generally inelastic and that price increases would lead to increased profit for the Postal Service. It is too early to firmly judge the impact of the implementation of the exigent prices, but it appears that the demand for mail services has not sharply declined due to the exigent surcharge. Revenue for all market dominant classes increased in FY 2014 compared to FY 2013.[32] Notably, Standard Mail revenue increased by 3.0 percent in FY 2014.[33]

In this proceeding, the Postal Service argues that DFS is a highly elastic mailer. While the Postal Service has proffered no evidence to support this assertion, it has provided some interesting statements regarding how it expects DFS to respond to the potential 2.5 percent rebate of this NSA.[34] The following table compares how the Postal Service states DFS will respond to the rebate in contract year 3, and how the Postal Service estimated that all Standard Mail Letter mailers would respond to the Docket No. R2013-10 CPI price increase.

**Table 7: CPI Price Increase and DFS Contract Year 3 Volume Response**

[32] Except for Periodicals, which decline by 0.1 percent. See USPS Form 8-K, filed November 14, 2014. http://www.prc.gov/Docs/90/90666/2014-11-14%20Form%208-K%201.pdf

[33] 2014 Form 8-K at powerpoint slide 3.

[34] As discussed above, the Postal Service has failed to explain why the removal of the exigent surcharge will have a negative impact on DFS' volume.

| | | Without Price Change | Volume With Price Change | Change in Volume |
|---|---|---|---|---|
| | | (Millions) | | |
| | | | | |
| **Standard Mail Letters** | | 48,432 | 48,164 | -268 |
| Response to R2013-10 | | | | |
| **DFS Standard Letters** | | 735 | 1,036 | 301 |
| Contract Year 3 | | | | |

In Docket No. R2013-11, the Postal Service estimated that the implementation of the Docket No. R2013-10 CPI price increase (roughly a 1.6 percent increase) would decrease volume by 268 million.[35] In this proceeding, the Postal Service states that decreasing prices by 2.5 percent for a mailer that accounts for 2 percent of Standard Mail letter volume will have a similar impact on volume as a 1.6 percent price change that impacts all mailers.

In the exigent case, the Postal Service applied its estimate of Standard Mail subclass elasticity of 0.447 to determine that a 1.6 percent change in price would lead to a 0.5 percent change in volume. In this case, the Postal Service asserts that a 2.5 percent change in price will lead to a 40.9 percent change in volume. The implied elasticity of the Postal Service's statement is -13.10.[36] The Postal Service states that it does "not believe the elasticities assumptions posited in the Commission's analyses are supported by the behavior of the mailers in general or of Discover."

It is difficult to understand why the Postal Service does not "believe" the elasticities implied by its statements of value.

### 5. The Postal Service's Failure to Meet Statutory and Regulatory Requirements Effectively Reduces the Commission's Review to 17 Days.

The Postal Service's failure to meet statutory and regulatory requirements hinders the administrative process. The Postal Service has regularly failed to meet the

[35] The file "Nick.Statmnt.Attach.Rev.11.22.13.xls" was used to create this table. Specifically, tab "Attach 1 – Mail Volume" cells J15 and N15 were used for the Total Standard Mail Volume forecast. Further, note that the J15 value for Standard Mail reflects a full year of implementation of the CPI prices. Tab "Attach 10 2014 Contribution" cell D21 was used for the Standard Mail Letters FY 2014 BR Forecast. Tab "Attach 12 2014 Cont AR 10-1-13" cell D21 was used for the Standard Mail Letters FY 2014 AR Forecast.

[36] See Postal Service Response to CHIR No. 1, question 9.

requirements of the Commission's regulations in 39 CFR 3010.40 *et seq.* in proceedings concerning market dominant NSAs, and this case is no exception.[37] The Postal Service's apparent refusal to follow the requirements of the statute and Commission's regulations for proceedings of this type hinders commenters' ability to provide meaningful comments and truncates the Commission's review. For those reasons, the Commission should ensure statutory and regulatory requirements are met; a complete record is filed; and the notice and review period required by 39 U.S.C. 3622(d)(1)(C) and 39 CFR 3010.41 is protected.

Receiving a complete record at the outset, as required by the Commission's regulations, is important because the Commission has 45 days to review the proposed NSA in accordance with 39 U.S.C. 3622(d)(1)(C) and 39 CFR 3010.41. In this proceeding, the Postal Service's Notice omitted several required pieces of information from its initial filing. For example, the Postal Service failed to provide a "projection of change in net financial position as a result of agreement . . . based on accepted analytical principles." 39 CFR 3010.42(f). In addition, the Postal Service failed to meet the requirements of 39 CFR 3010.43 (minimum requirements of the data collection plan); 39 CFR 3010.42(g) (identifying areas where the NSA will enhance performance); 39 CFR 3010.42(f)(5) (requiring that the Postal Service explain why it proposes to use an alternative methodology); and 39 CFR 3010.42(h) (requiring that the Notice explain how the NSA will avoid unreasonable harm to the marketplace). This information was not provided until the Postal Service responded to CHIR No. 1 on November 13, 2014—over two weeks into the Commission's review and two business days prior to the comment deadline.

Despite 39 U.S.C. 3622(d)(1)(C)'s 45 day notice requirement and the fact that the record was not clarified until a third of the review period had passed, the Postal Service asserts that it will implement the NSA on December 1, 2014. This further truncates the Commission's review and violates 39 U.S.C. 3622(d)(1)(C). The Postal Service filed its Notice with the Commission on October 27, 2014 and its notice in the

[37] *See, e.g.,* Docket No. MC2014-21 and R2014-6, Chairman's Information Request No. 1, March 19, 2014, questions 1, 3-4; Docket No. MC2012-14 and R2012-8, Chairman's Information Request No. 1, May 9, 2012, questions 1-2.

Federal Register on October 31, 2014. Forty-five days from publication of the Federal Register notice is December 15, 2014, yet the Postal Service intends to implement the contract on December 1, 2014—reducing the statutory and regulatory notice period by approximately a third. Notice at 1; Response to CHIR No. 1, question 12. Between a December 1, 2014 implementation date and an incomplete record until November 13, 2014, the Postal Service reduced the congressionally mandated 45 day review period to approximately 17 days in this proceeding. To ensure the requirements of 39 U.S.C. 3622(d)(1)(C) are met, the Commission should order that the NSA be implemented no earlier than December 15, 2014. In addition, the Commission should take steps to ensure that the Postal Service complies with the requirements of 39 CFR 3010.40 *et seq.* at the outset of future proceedings by denying insufficient requests without prejudice.

**6. It is unclear from the Record if the NSA will benefit the public**

The Postal Service continues to exist in financial limbo, as has been the case for much of the PAEA era. Market dominant domestic NSAs occupy an interesting place in the post-PAEA regulatory arena. Mailers not party to a NSA are protected from the negative result of a bad agreement by the CPI price cap. NSA volumes are included in the cap calculation at the non-discounted prices, and the Postal Service cannot increase its CPI cap space by offering lowered prices to some mailers. In that respect, the PAEA better protects mailers not party to NSAs than the Postal Reorganization Act did.

Due in part to the financial difficulties of the Postal Service, mailers care also impacted by Postal Service price and service changes outside of the CPI cap. Currently, all users of the mail are paying higher prices due to the exigent surcharge. In Docket No. R2013-11, the Postal Service argued that, due to the Great Recession, it needed to increase prices by 4.3 percent for all mailers in perpetuity. While the Commission capped the amount of surcharge at $2.776 billion in contribution, the Postal Service has appealed the Commission’s decision and argued that it should be allowed to collect the surcharge in perpetuity.

In addition to these higher prices, mailers will face longer service windows in FY 2015. Standard Mail service standards have recently been degraded via the "Load Leveling Plan," which extends the service standard window for much of Standard Mail by up to 2 days. The Postal Service has recently completed Phase 1 of its Mail Processing Network Realignment, during which it closed roughly 140 mail processing facilities and extended service standard times for certain First-Class and Periodicals mailings. The Postal Service has announced plans to implement Phase 2 of its Mail Processing Network Realignment in January of 2015, which will commence a new round of plant closures and significant degradation in First Class Overnight Delivery. The Postal Service has also decreased customer retail access, by, for example, implementing PostPlan in recent years.

While mailers remain protected by the price cap from any losses the DFS NSA may produce, mailers bear the burden of those losses in other ways. The changes in price and service all mailers have and will continue to experience as a result of the Postal Service's financial situation highlights that all mailers are impacted by the Postal Service's finances. The costs of an agreement, like the DFS NSA, that causes a negative net financial impact on the Postal Service, will ultimately be born by mailers in the form of reduced service and increased rates.

**a. The Postal Service's Potential Benefit from the Agreement**

Conversely, the ongoing network restructuring and exigent surcharge highlight why the Postal Service is acting rationally by entering into this NSA. If this NSA can increase contribution, the severe financial pressure on the Postal Service could be lessened (if only slightly). If this agreement is not implemented, it is possible that the revenue and contribution from DFS will decline. Of course, it is also possible that the revenue and contribution from DFS will decline even if the agreement is implemented. As detailed in these comments, the Postal Service has not provided sufficient information or quantitative analysis to assess whether the outcome is beneficial.

The Postal Service may have designed this NSA to balance risks and benefits. While it is possible that DFS would mail over $313 million in revenue without the benefit of a roughly $8 million rebate, it is understandable that the Postal Service would be willing to trade $8 million in contribution for the certainty that one of its largest customers will continue to mail at a high level. It is logical for companies to trade risk for certainty. Trading risk for certainty is only applicable if the Postal Service has reasonable evidence that DFS' revenue will decline, which this Record does not support. Furthermore, the statute requires agreements such as this one to improve the net financial position of the Postal Service, and as previously described, the Record does not contain information sufficient to make such a finding.

#### b. Agreement is not in the Public Interest if it has a negative financial impact

The DFS NSA is not in the public interest if it will have a negative financial impact on the Postal Service. It is unfortunate, then, that the Postal Service has not provided the information needed to make an informed assessment as to the agreement's financial impact. If the Postal Service misjudged the mailing plans of DFS and DFS would have mailed the same amount of First Class and Standard Mail without the agreement, the Postal Service will lose roughly $24 million in contribution (the aggregate of three years of discounts). Given the Postal Service's financial difficulties, other mailers will certainly have to cover that $24 million, either in higher prices or lessened service. This would plainly not serve the public interest. Conversely, even if the agreement created a modest gain in contribution, other stakeholders would benefit. However, the balance of the information of the case does not support implementation, as outlined in these comments. The Postal Service's estimate of a $94 million benefit from offering a marginal discount of less than 1 cent is not economically rational or actionable.

### 7. The Postal Service is attempting to remove regulatory oversight

Given the Postal Service's repeatedly stated belief that this NSA is a good idea, the Public Representative is concerned that the Record is devoid of the information necessary for the Commission to approve the agreement. The Postal Service has repeatedly stated that the regulatory burden associated with Commission approval of NSAs limits its pricing flexibility. While this may be the case, the current statutory scheme calls for regulatory oversight over NSAs and the PAEA created the framework within which both the Postal Service and the Commission must now operate.

**a. Postal Service had 4 years to develop new method for analysis**

As discussed above, the proposed DFS NSA is similar to the previous DFS NSA. The results of applying the Commission's approved methodology to an agreement of this type are hardly a surprise. The Public Representative is willing to acknowledge that there may be an alternative methodology to the Commission's accepted methodology that would be a better tool for analyzing the financial impact of agreements of this type. In Docket No. R2011-3, the Public Representative offered an alternative methodology for evaluating the financial impact of the agreement. In that proceeding, the Commission stated that the Postal Service "should consider exploring this approach when analyzing similar agreements" and found that the methodology "may also be valuable for performing an after-the-fact analysis of the agreement."[38]

The Postal Service has had ample opportunity over the last four years to develop that methodology further and propose that that methodology replace the Commission's current one. The Postal Service also has had ample opportunity to develop and propose a completely new methodology. Despite these options, the Postal Service has not chosen to develop and propose alternatives, and the Commission's accepted methodology remains the sole accepted way to evaluate an agreement's net financial impact.

**b. Postal Service is providing Commission with a false choice**

The Postal Service appears to be offering the Commission the following choice: (1) approve this NSA and ignore the requirements of 39 CFR 3010.40 and 39 U.S.C. 3622(c)(10), or (2) withhold approval of the DFS NSA and prevent the Postal Service from implementing an agreement that it "believes" is worth nearly $100 million.

**c. Commission has two reasonable paths forward**

[38] Order No. 694 at 15.

The Commission has alternatives to the false choice posed by the Postal Service. The Commission could find that this NSA does not meet statutory requirements or it could attempt to fill in the holes in the Record. While the previous DFS NSA appears to have had a significant negative impact on the Postal Service's finances, it is clear that DFS experienced significant volume growth at a time when Standard Mail was generally flat. Further, it is clear that DFS is a major partner of the Postal Service. Reviewing DFS' Annual Report, it appears that DFS spends over half of its marketing budget on mail.[39] Thus, as an alternative to outright approving or denying implementation of the agreement, the Public Representative offers two alternative paths forward. First, the Commission could hold this NSA in abeyance and open a rulemaking to develop an alternative methodology for evaluating NSAs of this type. Second, the Commission could conditionally approve this NSA for a shorter period and order the Postal Service to petition for a rulemaking on an alternative methodology.

Both approaches would give postal stakeholders the information needed to understand the value of this NSA to the Postal Service, would ensure that the agreement provides the Postal Service with a net financial benefit, and would allow for creation of an alternative methodology based in quantitative analysis and economic principles. As detailed in these comments, the Postal Service's filings in this proceeding have severely limited the ability of the Commission to develop a full understanding of the likely impacts of this NSA.

Respectfully Submitted,

JP Klingenberg
Public Representative Docket No. R2015-2

901 New York Avenue, N.W., Suite 200
Washington, DC 20268-0001
Phone (202) 789-6863; Fax (202) 789-6891
Email: john.klingenberg@prc.gov

[39] See Discover Financial Services 2013 Annual Report at 30-31. "We incur considerable expenses in competing with other consumer financial services providers to attract and retain customers and increase usage of our products. A substantial portion of these expenses relates to marketing expenditures. We incurred expenses of $717 million in the 2013 calendar year and $603 million and $537 million in the 2012 and 2011 fiscal years, respectively, for marketing and business development."

# Appendix A – History of Postal Service NSA Projections

| Appendix A- History of Postal Service NSA Projections and Results | | | | |
|---|---|---|---|---|
| | | **Year 1** | **Year 2** | **Year 3** |
| **Capital One** | **Without Agreement** | 1,310 | 1,238 | 1,210 |
| | **With Agreement** | 1,423 | N/A | N/A |
| | **Actual** | 1,396 | 1,305 | 1,201 |
| **Accuracy of Projection** | | -1.9% | | |
| **Discover** | **Without Agreement** | 451 | 446 | 441 |
| | **With Agreement** | 464 | 465 | 461 |
| | **Actual** | 497 | 495 | 424 |
| **Accuracy of Projection** | | 7.1% | 6.5% | -8.0% |
| **Chase/Bank One** | **Without Agreement** | 1,042 | 990 | 1,016 |
| | **With Agreement** | n/a | 1148 | 1178 |
| | **Actual** | 938 | 1,104 | 1,013 |
| **Accuracy of Projection** | | | 11.5% | -0.3% |
| **HSBC** | **Without Agreement** | 641 | 784 | 856 |
| | **With Agreement** | 657 | 798 | 876 |
| | **Actual** | 603 | 581 | 472 |
| **Accuracy of Projection** | | -8.2% | -27.2% | -46.1% |
| **Bookspan** | **Without Agreement** | 78 | 75 | 75 |
| | **With Agreement** | 105 | 105 | 107 |
| | **Actual** | 96 | 103 | 58 |
| **Accuracy of Projection** | | -8.6% | -1.9% | -45.8% |
| **Bradford** | **Without Agreement** | 200 | 202 | 204 |
| | **With Agreement** | 226 | 225 | 227 |
| | **Actual** | 228 | 197 | 179 |
| **Accuracy of Projection** | | 0.9% | -12.4% | -21.1% |
| **Lifeline** | **Without Agreement** | 90 | 87 | 87 |
| | **With Agreement** | 104 | 110 | 110 |
| | **Actual** | 98 | 90 | 79 |
| **Accuracy of Projection** | | -5.8% | -18.2% | -28.2% |
| **Discover** | **Without Agreement** | $ 206 | $ 219 | $ 229 |
| | **With Agreement** | $ 218 | $ 228 | $ 237 |
| | **Actual** | $ 265 | $ 277 | $ 284 |
| **Accuracy of Projection** | | 21.6% | 21.5% | 19.8% |

All data is taken from the Commission’s orders approving the agreements and the data collection reports filed by the Postal Service. For the Bookspan, Bradford, Lifeline, and Discover NSA, data was also filed in the ACD.

The Chase/Bank One NSA represents a special case. The NSA was originally proposed as a Bank One NSA, and during that proceeding Bank One and Chase merged. During the docket, the Postal Service stated that Chase would mail 471 million pieces in contract year 1 without the agreement. Further, the Postal Service did not make a statement regarding Chase volume with the agreement. Thus, for contract year 1 there is no statement of “with agreement” volume. The Chase/Bank One discount was adjusted upwards by 373 million to account for the merger, even though the Postal Service stated that Chase would mail 471 million pieces without the agreement. The discount cap was reached in contract year two of the agreement, so that accuracy of the projection compares the actual volume with the Postal Service’s statement of volume without the agreement, as no agreement was in effect.

The following table details the calculation of average accuracy of the Postal Service’s projection.

| Absolute Value of the Postal Service's Accuracy of Projection | | | |
|---|---|---|---|
| | **Year 1** | **Year 2** | **Year 3** |
| **Capital One** | 1.90% | | |
| **Discover** | 7.11% | 6.45% | 8.03% |
| **Chase/Bank One** | | 11.52% | 0.30% |
| **HSBC** | 8.22% | 27.19% | 46.12% |
| **Bookspan** | 8.57% | 1.90% | 45.79% |
| **Bradford** | 0.88% | 12.44% | 21.15% |
| **Lifeline** | 5.77% | 18.18% | 28.18% |
| **Discover** | 21.56% | 21.49% | 19.83% |
| | | | |
| **Average** | 7.72% | 14.17% | 24.20% |

The absolute value of the difference between the projection and the actual result is used.

Appendix B – Discussion of Rebate and Penalty Structure

The following table details the penalty and rebate scenarios for potential DFS revenues in contract year one.

**Table 2: Potential Revenue and Rebate Scenarios**

| DFS Potential Contract Year 1 Revenues | | | | |
|---|---|---|---|---|
| | Postal Service Projected Without Agreement | Threshold | Tier 1 | Postal Service Projected With Agreement |
| **DFS Contract Year 1 Revenue** | $ 267,863,160 | $ 313,174,664 | $ 313,174,665 | $ 324,652,354 |
| **Penalty** | $ 4,531,150 | $ 0.10 | $ - | $ - |
| **Rebate** | $ - | $ - | $ 7,046,430 | $ 8,116,309 |

- Penalty

If DFS does not reach the revenue threshold, DFS will not receive rebates and will be required to pay 10 percent of the difference between the revenue threshold and the actual revenue. In two of the scenarios shown in Table 2, the hypothetical revenue falls short of the of the rebate threshold. In the scenario "Postal Service Projected Without Agreement," the Postal Service's projection of DFS contract year 1 volume and revenue without the agreement is used. The Postal Service projects DFS revenue of $267 million, absent the agreement. If the agreement is implemented and DFS contract year 1 revenue is $267 million, it would be $45 million short of the revenue threshold. The contract requires a penalty of 10 percent of the shortfall between actual revenue and the revenue threshold if the threshold revenue is not reached. If DFS revenue is $267 million in contract year one, DFS will owe a penalty of $4.5 million. In the second scenario "Threshold," DFS falls 1 dollar short of the rebate threshold. The 10 percent penalty in that instance would be 10 cents.

- Rebate

As detailed in Table 1, Tier 1 will apply for revenues between $313 million and $316 million in contract year 1, and Tier 2 will apply for all revenue over $316 million. In the Table 2 hypothetical, if DFS has a revenue equal to the Tier 1 threshold in contract year 1, it will receive $7 million in rebates, or 2.25 percent of $313 million. The Postal

Service projects that DFS will exceed the Tier 2 rebate threshold in all three of the contract years. If DFS revenue is $325 million in contract year 1, as projected by the Postal Service, DFS will receive a rebate of $8 million, or 2.5 percent of $325 million.